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In The

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1969

EUGENE P. RUEHLMANN, EXECUTOR OF THE ESTATE OF FRANCES FOSTER WELLS, DECEASED,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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NO. .....

EUGENE P. RUEHLMANN, EXECUTOR OF THE ESTATE OF FRANCES FOSTER WELLS, DECEASED,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

The petitioner Eugene P. Ruehlmann respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Sixth Circuit entered in this proceeding on November 26, 1969.

OPINIONS BELOW

The opinion of the Court of Appeals, 418 F.2d 1302 (1969), appears in the Appendix hereto. The opinion of the Tax Court of the United States, 50 T.C. 871 (1968), is also reproduced in the Appendix hereto.

JURISDICTION

The judgment of the Court of Appeals for the Sixth Circuit was entered on November 26, 1969. An Application for Extension of Time in which to File Petition for Writ of Certiorari was timely filed and an Order Extending Time to File Petition for Writ of Certiorari was granted by Mr. Justice Stewart on February 24, 1970, thereby extending the time for filing this petition to April 25, 1970. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. Whether the method of valuation of open-end investment company shares for federal estate tax purposes found in Treasury Regulation Section 20.2031-8(b) provides a correct measure of value for such shares?

2. Whether the proper method of valuation of open-end investment company shares for federal estate tax purposes is one based upon the public redemption price in effect at the valuation date?

STATUTORY PROVISIONS INVOLVED

United States Code, Title 26:

§ *2031 Definition of Gross Estate*

"(a) General. — The value of the gross estate of the decedent shall be determined by including to the extent provided for in this part, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated.

"(b) Valuation of Unlisted Stock and Securities. — In the case of stock and securities of a corporation the value of which, by reason of their not being listed on an exchange and by reason of the absence of sales thereof, cannot be determined with reference

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to bid and asked prices or with reference to sales prices, the value thereof shall be determined by taking into consideration, in addition to all other factors, the value of stock or securities of corporations engaged in the same or a similar line of business which are listed on an exchange."

Treasury Regulation, § 20.2031-8(b)

"(b) *Valuation of shares in an open-end investment company.* (1) The fair market value of a share in an open-end investment company (commonly known as a 'mutual fund') is the public offering price of a share, adjusted for any reduction in price available to the public in acquiring the number of shares being valued. * * *"

STATEMENT OF THE CASE

The case involves the single issue of whether or not Treasury Regulation § 20.2031-8(b) is invalid as being arbitrary, unreasonable and inconsistent with the statutory language of § 2031 of the Internal Revenue Code of 1954 (26 U.S.C. § 2031). More specifically, the issue is whether shares in an open-end investment company (mutual fund) should be valued for federal estate tax purposes at the public offering price or the public redemption price in effect on the valuation date.

This case was submitted to the Tax Court upon full stipulation of fact. None of the facts set forth herein are in controversy.

An open-end investment company or mutual fund is an organization which sells shares in itself and with the proceeds therefrom invests in securities of other firms. A mutual fund issues as many of its shares as can be marketed and continually offers its shares to the public. A mutual fund continually offers to redeem its outstanding shares from the holders thereof. The price at which

mutual funds offer their shares to the public (quoted in financial publications as the "asked" price) is the net asset value, which is the fractional value per share outstanding of the fund's net assets, plus a "sales load" or "sales charge." The "sales load" or "sales charge" is a commission paid to underwriters and dealers for the service of marketing the mutual fund shares. The mutual fund itself receives none of the "sales load." The price at which mutual funds will redeem their shares (quoted in financial publications as the "bid" price) is the net asset value, which is the fractional value per share outstanding of the funds' net assets. Except for a negligible number of transfers between individuals, all transactions with respect to mutual fund shares take place with the particular fund whose shares are involved.

Petitioner, as Executor for the Estate of Frances Foster Wells, deceased, valued the open-end investment company shares owned by decendent on the date of her death at the public redemption price in effect on the valuation date. The Commissioner of Internal Revenue determined that the shares should be valued at the public offering price pursuant to Treasury Regulation § 20.2031-8(b). Petitioner challenged the valuation method set forth in the Treasury Regulations as being arbitrary, unreasonable and inconsistent with the statute.

The Tax Court of the United States, sitting *en banc*, upheld the validity of Treasury Regulation § 20.2031-8 (b). Six judges of the Tax Court dissented. The United States Court of Appeals for the Sixth Circuit affirmed the majority of the Tax Court.

REASONS FOR GRANTING THE WRIT

I. THE DECISION BELOW HAS DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW AFFECTING MILLIONS OF TAXPAYERS, WHICH QUESTION HAS NOT BEEN, BUT SHOULD BE, SETTLED BY THIS COURT.

The United States Court of Appeals for the Sixth Circuit has upheld Treasury Regulation § 20.2031-8(b), which provides a measure of value which no owner of mutual fund shares, including the mutual fund itself, ever realizes on the sale of mutual fund shares. The Treasury Regulation deviates so blatantly from the classic willing buyer — willing seller standard of valuation as to be inconsistent with the intent of Congress as expressed in the Internal Revenue Code § 2031 (26 U.S.C. § 2031). In addition, the Treasury Regulation is inconsistent with other valuation regulations.[1] Treasury Regulation § 20.2031-8(b) is arbitrary, unreasonable, inconsistent with the statute and should be ruled invalid.

A. Large Number of Taxpayers Affected.

Open-end investment company shares (commonly called mutual fund shares) are owned by approximately 4,836,000 individual investors. In 1969, approximately 610,000 individuals purchased an aggregate of over $5,970,000,000 of mutual fund shares. The total volume of "load charges" paid in 1969 exceeded $35,600,000. The total dollar

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[1] For example, see Treasury Regulation § 20.2031-2 "Valuation of Stocks and Bonds," which does not include commissions paid for purchases and sales of stocks or bonds as elements of value for federal estate tax purposes.

volume of mutual fund shares held by individuals as of December 31, 1969 is approximately $42,921,000,000.[2]

The valuation issue contested herein is present in every estate tax return for a decedent who owned one or more mutual fund shares at death. As indicated by the number of investors and the volume of investment in mutual fund shares, potentially millions of taxpayers are affected by the decision of the Court of Appeals.

B. Concern of the Tax Bar.

The concern of the practicing tax bar over this arbitrary administrative fiat can be illustrated by the recommendation of the Committee on Estate and Gift Taxes of the American Bar Association that legislation be passed to overrule Treasury Regulation § 20.2031-8(b) and its federal gift tax counterpart. The American Bar Association proposed that the Internal Revenue Code be amended in § 2031 to provide a new subparagraph (d), as follows:

> "(d) Valuation of Shares of a Mutual Fund — In the case of shares in an open-end investment company registered under the provision of the Investment Company Act of 1940, the value thereof shall be determined by the redemption price for such shares."[3]

In making its recommendation, the American Bar Association recognized that the issue herein is one of wide-spread concern, and one which is best suited for judicial review. Its reasons for proposing the extraordinary remedy of legis-

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[2] All figures were supplied by the Investment Company Institute, 1775 K Street N.W., Washington, D. C. 20006. For additional statistics on the broad base of mutual fund investment in the United States, the Court's attention is directed to the "1969 Mutual Fund Fact Book," published by the Investment Company Institute.

[3] H.R. 662, 90th Congress, 1st Session. See also, H.R. 4458, 90th Congress, 1st Session.

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lative change are set forth in the *Bulletin of the American Bar Association,* Volume XIX, Number 4, July, 1966, and summarized therein as follows:

> "In advocating this legislative proposal, the Committee points out that the amended Estate and Gift Tax Regulations affect all taxpayers transferring tangible personal property or mutual fund shares either at death or by gift, and it is thus a problem which has been brought to the Committee's attention by a large number of attorneys. Since in the vast majority of cases the additional estate or gift tax resulting from such amended Regulations would be too small to warrant the cost of litigating the issue, the Committee feels that remedial legislation along the lines hereinabove proposed is warranted."

C. Continuing Impact Upon Taxpayers.

The continuing concern of tax practitioners throughout the United States has been directly called to the attention of counsel for petitioner in the form of correspondence and telephone calls from members of the bar of virtually every state in the nation regarding the progress of the instant case. The issue is still being litigated in the lower courts. See, *Robert C. Davis, Executor of the Estate of Isabelle M. Davis* v. *United States,* 306 F. Supp. 949 (Dist. Ct. Central Dist. Cal. 1969), on appeal to the U.S. Court of Appeals for the Ninth Circuit; *Stanley W. York, Executor of the Estate of Lovina R. York* v. *Commissioner,* 28 TCM 1271, T.C. Memo, 1969-246 (1969); and *Douglas B. Cartwright, Executor of the Estate of Ethel B. Bennett* v. *United States,* U.S. District Court for the Western District of New York, Civil No. 1968-164, trial held April 3, 1970 and no decision rendered to date. To the best knowledge of counsel, the issue is also pending in numerous federal estate tax audits throughout the country. The

issue is clearly not an isolated one, but is one which is undoubtedly recurring every day in a very significant number of estate tax cases, and will continue to recur until settled by this Court.

The proper administration of the federal tax law in accordance with the intent of Congress requires that the question raised herein be finally settled by this Court.

II. THE DECISION BELOW IS DIRECTLY IN CONFLICT WITH THE DECISION OF ANOTHER FEDERAL COURT.

The decision of the Sixth Circuit in the instant case is directly in conflict with the decision of the U. S. District Court for the Central District of California in *Robert C. Davis, Executor of the Estate of Isabelle M. Davis* v. *United States, supra.* In *Davis,* the Court held that Treasury Regulation § 20.2031-8 (b) is invalid and that mutual fund shares should be valued at the redemption price for federal estate tax purposes.

Petitioner recognizes that this Court does not often grant a writ of certiorari merely because a conflict exists between a Circuit Court and a District Court. Petitioner recognizes that there is no conflict to date among Circuit Courts. However, petitioner stresses the importance of the issue in this case, the number of taxpayers involved, the continued and pending litigation in the lower courts, and the need for a final determination of this issue. This Court, has issued writs of certiorari under similar circumstances. *United States* v. *Constantine,* 296 U.S. 287 (1935).

The decision in *Davis, supra,* is being appealed to the United States Court of Appeals for the Ninth Circuit, the Notice of Appeal having been filed January 15, 1970. However, due to the time limitations imposed by the procedural rules of this Court, petitioner is unable to with-

hold submission of this petition until a decision is reached by the Ninth Circuit Court. Since the government is the appellant in the Ninth Circuit, it is conceivable that a conflict between circuit courts could arise, but that there would be no petition for writ of certiorari to settle the conflict. This regrettable set of circumstances could evolve because it may be to the government's advantage to retain the status quo without seeking an ultimate decision by this Court on the validity of the Treasury Regulation.

In order to settle the existing and potentially growing conflict between federal courts on the issue in controversy, this Court is respectfully requested to issue a writ of certiorari to the Sixth Circuit. In the alternative, it is respectfully requested that this Court hold in abeyance its determination upon this petition until the decision is rendered by the United States Court of Appeals for the Ninth Circuit in the *Davis* case.

III. THE DECISION BELOW IS INCONSISTENT WITH DECISIONS OF THIS COURT IN CASES DEALING WITH VALUATION FOR FEDERAL TAX PURPOSES.

In the cases of *Guggenheim* v. *Rasquin,* 312 U.S. 254 (1941), *Powers* v. *Commissioner,* 312 U.S. 259 (1941), and *United States* v. *Ryerson,* 312 U.S. 260 (1941), this Court had occasion to rule on the proper method of valuation of single premium life insurance policies for federal gift tax purposes. The rule developed in these cases was applied in a federal estate tax case in *DuPont's Estate* v. *Commissioner,* 233 F.2d 210 (3d Cir. 1956), certiorari denied, 352 U.S. 878.

Mr. Justice Douglas, in *Guggenheim* v. *Rasquin, supra,* disregarded cash surrender value (redemption value) as the measure of value of a single premium life insurance

policy. In justifying the use of replacement cost, his opinion recognizes the unique elements of value inherent in life insurance contracts:

> "Surrender of a policy represents only one of the rights of the insured or beneficiary. . . . But the owner of a fully paid life insurance policy has more than the mere right to surrender it; he has the right to retain it for its investment virtues and to receive the face amount of the policy upon the insured's death. That these latter rights are deemed by purchasers of insurance to have substantial value is clear from the difference between the cost of a single premium policy [$852,438.50] and its immediate or early cash surrender value [$717,344.81] — in the instant case, over $135,000.00 [The face value of the policy was $1,000,000.00]. All of the economic benefits of a policy must be taken into consideration in determining its value for gift tax purposes. To single out one and to disregard others is in effect to substitute a different property interest for the one which was the subject of the gift . . ."

Having recognized the unique nature of an investment in life insurance, Mr. Justice Douglas went on to point out that the record in that case offered no evidence of a better measure of value which recognized these unique elements than the measure chosen by the Court:

> "Presumptively the value of the policies at the date of the gift was the amount which the insured had expended to acquire them. Cost is cogent evidence of value. And here it is the *only suggested criterion* which reflects the value *to the owner* of the entire bundle of rights in a single premium policy — the right to retain it as well the right to surrender it. *Cost in this situation is not market price in the normal sense of the term. But the absence of market price is no barrier to valuation.*" (Italics supplied)

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One need not dwell on the obvious distinction as to the nature and quality of insurance policies and annuity contracts as opposed to mutual fund shares. The former have built into them a variable, life expectancy, which makes valuation a constant guessing game using statistics and actuarial tables. Mutual funds are valued by mere mathematical computation of their net asset value and this valuation is widely published throughout the financial world. With mutual fund shares, there is no conjecture, no guessing or estimating, no use for statistical tables or "best evidence" determinations. Insurance policies and annuity contracts have no such readily ascertainable values, but instead have a mortality variable which makes their valuation a unique exercise. This Court recognized this unique problem and solved it with the best evidence available to it.

In the instant case, the best evidence of value to the owner is the public redemption price (bid price). The public redemption price or net asset per share is the price the mutual fund receives when it sells its shares and it is the price an investor receives when he sells or redeems his shares. There is no evidence on the record of any other price that an owner of mutual fund shares receives.

This Court deviated from the classic willing buyer — willing seller concept of fair market value in the *Guggenheim* v. *Rasquin* line of cases because there was an "absence of a market price." In the instant case, there is a clear and well defined market price. There is no logical reason to deviate from classical valuation concepts to resort to cost as the best available evidence of market price of mutual fund shares, as the Treasury Regulations would have us do.

The Commissioner and the Treasury Department have misinterpreted and misapplied this Court's holding in the *Guggenheim* v. *Rasquin* line of cases and this Court should now correct this misunderstanding.

CONCLUSION

The decision of the United States Court of Appeals for the Sixth Circuit has upheld a Treasury Regulation which is arbitrary, unreasonable, inconsistent with the intent of Congress, and should be ruled invalid. The valuation method set forth in the Treasury Regulation cannot stand on its merits, and has been upheld solely upon the presumption of merit accorded administrative fiat.

The decision below continues to effect millions of taxpayers, and continues to concern counsel throughout the United States. Litigation of the issue continues, and the federal courts are now in conflict. The valuation rulings of this Court have been misinterpreted and misapplied. Only by granting this petition for writ of certiorari can this Court stem the rising tide of confusion and inequity caused by the Treasury Department and fostered by the decision below.

In the alternative, this Court is respectfully requested to hold its decision upon this petition in abeyance until the United States Court of Appeals for the Ninth Circuit has rendered a decision in the *Davis* case now on appeal.

Respectfully submitted,

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April, 1970.

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APPENDIX A

(Filed November 26, 1969)

No. 19259

UNITED STATES COURT OF APPEALS
For the Sixth Circuit

EUGENE P. RUEHLMAN, Executor of the ESTATE OF FRANCES FOSTER WELLS, Deceased,
Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

ON PETITION for Review of a Decision of the Tax Court.

Decided November 26, 1969.

Before: WEICK and COMBS, Circuit Judges, and TAYLOR, District Judge.*

COMBS, Circuit Judge. At issue is the proper valuation for estate tax purposes of shares in an open-end or mutual fund investment company. The Tax Court upheld the validity of Treasury Regulation § 20.2031-8 (b), which provides that the value shall be the fair market value of

*Honorable Robert L. Taylor, Chief Judge, United States District Court for the Eastern District of Tennessee, sitting by designation.

a share determined by the public offering price adjusted for any available reduction in price due to a block sale. 50 T.C. 871 (1968). Six judges dissented from the Tax Court's decision. The taxpayer in his petition for review contends that the regulation is unreasonable and improper.

Shares in open-end investment companies are sold to the public at a price fixed by law based on the net value of the property owned by the company. The issuing company is required by law to redeem its outstanding shares from the public at their current net asset value. Investment Company Act of 1940, 15 U.S.C. § 80a-22 (1964). The public offering price of open-end investment company or mutual fund shares includes a "sales load" which goes to the underwriter who acts as agent for the fund.

The Tax Court found that the resale market in mutual fund shares is negligible except for redemptions by the issuing company. For purposes of analysis it was assumed that all sales by the public of mutual fund shares are to the investment company itself. The price at which the fund will buy back its shares is based solely on the net asset value. The taxpayer here contends that, since the estate could obtain only the net asset value or bid price if it sold the shares to the company, that price limits the fair market value of the shares for estate tax purposes.

Pursuant to Internal Revenue Code § 2031 (a) and the authority to issue "needful rules and regulations" in 26 U.S.C. § 7805 (a), the Commissioner has issued a series of regulations which provide that the general criterion of value for estate tax purposes shall be fair market value determined by the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts. Treasury Regulation § 20.2031-1 (b). For stocks and bonds sold over the counter or on a stock exchange their fair market

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value is prescribed by regulation to be the mean between the highest asked and lowest bid prices on the valuation date. Treasury Regulation § 20.2031-2. There being no similar market for shares in open-end investment companies, the Commissioner published in 1963 a regulation providing that the fair market value of shares in an open-end investment company is the public offering price of the shares. Treasury Regulation § 20.2031-8 (b). The question is whether that regulation is reasonable and consistent with § 2031 of the Internal Revenue Code. The criterion to be applied in determining value is a matter of law. *Powers* v. *Commissioner,* 312 U.S. 259 (1941). If a treasury regulation is reasonable and consistent with the statute, it should be sustained. *Commissioner* v. *South Texas Co.,* 333 U.S. 496, 501 (1948).

The only sale which can be pointed to in the instant case which represents a transaction between a willing buyer and a willing seller is the original issue of the mutual fund shares to a purchaser at the public offering price. Retail sales price or the price to the ultimate consumer is a familiar determinant of fair market value in the estate tax context. See *Goldman* v. *Commissioner,* 388 F.2d 476 (6th Cir. 1967); Treasury Regulation § 20.2031-1 (b).

Petitioner contends that the redemption price should be the determinant of value because that price represents the amount which the decedent or the estate would have received had the shares been sold on the valuation date. However, this is not necessarily the only criterion of value for estate tax purposes. Value may be determined by an objective standard if it is not unreasonable. The hypothetical "willing buyer" and "willing seller" are presumed to act objectively based upon their knowledge of the relevant facts. *United States* v. *Simmons,* 346 F.2d 213, 217 (5th Cir. 1965).

Logical argument can be made for either the bid price or the asked price as the criterion of value for mutual fund shares. Prior to 1963, some estate taxpayers valued mutual fund shares at the bid price, and others chose to treat them like stock sold through an exchange and reported an average between the bid price and the asked price.[1] The Commissioner has chosen a third criterion and, if it is a reasonable one, we are not at liberty to second guess him. In *United States* v. *Correll*, 389 U.S. 299, 306 (1967), the Court has furnished these guidelines for a court reviewing a treasury regulation:

> "Alternatives to the Commissioner's . . . rule are of course available. Improvements might be imagined. But we do not sit as a committee of revision to perfect the administration of the tax laws. Congress has delegated to the Commissioner, not to the courts, the task of prescribing 'all needful rules and regulations for the enforcement' of the Internal Revenue Code. 26 U.S.C. § 7805 (a). In this area of limitless factual variations, 'it is the province of Congress and the Commissioner, not the courts, to make the appropriate adjustments.' *Commissioner* v. *Stidger*, 386 U.S. 287, 296. The role of the judiciary in cases of this sort begins and ends with assuring that the Commissioner's regulations fall within his authority to implement the congressional mandate in some reasonable manner."

Mearkle's Estate v. *Commissioner*, 129 F.2d 386, 388 (3rd Cir. 1942), is to the same effect.

We hold that the regulation in question is a reasonable one and is consistent with the statute. Our conclusion is supported by a recent decision of the Seventh Circuit involving the determination of the value of mutual fund

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[1] Legislation which would clarify this point has been introduced in Congress. H. R. 662, 90th Cong., 1st Sess. (1967).

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shares for gift tax purposes. *Howell* v. *Commissioner,* 414 F.2d 45 (1969). The rule applicable to a gift tax also applies to estate taxes.

The judgment of the Tax Court is affirmed.

APPENDIX B

[CCH Dec. 29,130] Estate of Frances Foster Wells, Deceased, Eugene P. Ruehlmann, Executor v. Commissioner. Docket No. 5691-66. 50 TC 871, No. 88. Filed September 16, 1968.

[1954 Code Sec. 2031]

[Estate tax: Valuation of mutual fund shares: Public offering price v. redemption price.] *Held:* Shares in open-end investment companies or mutual funds were properly valued for estate tax purposes at the public offering price on the date of death in accordance with section 20.2031-8 (b), Estate Tax Regs., rather than at the redemption price.

Michael D. Rose, for the petitioner. Conley G. Wilkerson, for the respondent.

Opinion

TIETJENS, Judge: The Commissioner determined a deficiency in estate tax in the amount of $2,328.25.

The only issue is whether the Commissioner properly valued for estate tax purposes the shares of certain open-end investment companies. He valued them pursuant to section 20.2031-8 (b),[1] Estate Tax Regs., the validity of which is in contention.

[1] Sec. 20.2031-8 Valuation of certain life insurance and annuity contracts; valuation of shares in an open-end investment company.

All of the facts are stipulated and so far as pertinent are as follows:

The petitioner is Estate of Frances Foster Wells, deceased, Eugene P. Ruehlmann, executor. Eugene P. Ruehlmann's business address at the time this petition was filed was and now is 1800 First National Bank Building, Cincinnati, Ohio.

Frances Foster Wells died testate January 27, 1964, a resident of Cincinnati, Ohio. The Federal estate tax return of Frances Foster Wells was timely filed with the district director of internal revenue, Cincinnati, Ohio, on April 27, 1965.

At the date of her death, January 27, 1964, Frances Foster Wells owned shares in open-end investment companies or mutual funds as follows:

	No. of Shares
Massachusetts Investors Trust	1,073
The Geo. Putnam Fund of Boston	3,876.638
Wellington Fund, Inc.	1,031.601

A mutual fund or open-end investment company is an organization which sells shares in itself and with the proceeds therefrom invests in securities of other firms. A mutual fund or open-end investment company issues as

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(a) *Valuation of certain life insurance and annuity contracts.* (1) The value of a contract for the payment of an annuity, or an insurance policy on the life of a person other than the decedent, issued by a company regularly engaged in the selling of contracts of that character is established through the sale by that company of comparable contracts. • • •

• • •

(b) *Valuation of shares in an open-end investment company.* (1) The fair market value of a share in an open-end investment company (commonly known as a "mutual fund") is the public offering price of a share, adjusted for any reduction in price available to the public in acquiring the number of shares being valued. • • •

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many of its shares as can be marketed and continually offers its shares to the public. Also a mutual fund or open-end investment company continually offers to redeem its outstanding shares from the holders thereof. The open-end investment companies or mutual funds whose shares were included in the taxable estate of Frances Foster Wells sell their shares to the public through management companies and/or "underwriters" acting as agents for and pursuant to contracts with the open-end investment companies or mutual funds.

Customarily, the price at which open-end investment companies or mutual funds offer their shares to the public (quoted in financial publications as the "asked" price) is the net asset value which is the fractional value per share outstanding of the fund's net assets, plus a "sales load" or "sales charge." The "sales load" or "sales charge" goes entirely to the management companies and/or "underwriters" for their services in marketing the shares. The "sales load" represents a percentage of the offering price and varies between a maximum and minimum charge depending on the quantity purchased in a single transaction. The "sales load" with respect to each of the funds herein involved as of January 27, 1964, was as follows:

	Maximum (Percent)	Minimum (Percent)
Massachusetts Investors Trust	8.5	1.75
The Geo. Putnam Fund of Boston	8.5	1.0
Wellington Fund, Inc.	8.0	2.25

There are in existence open-end investment funds which do not include a "load charge" in their public offering price. Both the public offering price "asked" and the public redemption price "bid" for shares in such a fund

are equal to the net asset value of such shares. The Scudder, Stevens & Clark Common Stock Fund, Inc., is such a "no-load" fund.

The price at which open-end investment companies or mutual funds will redeem their shares (quoted in financial publications as the "bid" price) is the net asset value, which is the fractional value per share outstanding of the funds' net assets.

The "bid" and "asked" prices for open-end investment companies or mutual fund shares represent the prices at which transactions with the open-end investment companies or mutual funds take place rather than the range of negotiations and transactions. Except for a negligible number of transfers between individuals, all transactions with respect to open-end investment companies or mutual fund shares take place with the particular open-end investment company or mutual fund whose shares are involved.

The open-end investment company or mutual fund shares involved herein were reported in the estate tax return filed by the Estate of Frances Foster Wells at the following valuation per share:

Massachusetts Investors Trust	$15.72
The Geo. Putnam Fund of Boston	15.62
Wellington Fund, Inc.	14.75

On the date of the death of Frances Foster Wells, January 27, 1964, Massachusetts Investors Trust, The Geo. Putnam Fund of Boston, and Wellington Fund, Inc., were offering and sold shares in their respective companies to the public (asked price) and were offering to and did redeem shares in their respective companies from the holders thereof (bid price) as follows:

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	Asked Price	Bid Price
Massachusetts Investors Trust	$17.18	$15.72
The Geo. Putnam Fund of Boston	17.07	15.62
Wellington Fund, Inc.	16.08	14.75

These "bid" and "asked" prices were not subject to negotiation but represent the prices at which transactions with the above referred to open-end investment companies took place on the date indicated, rather than the range of negotiations and transactions, excepting those transactions that may have occurred whereby shares were purchased from the funds in sufficient quantities that quantity purchase discounts, representing reductions in per share purchase price, were allowed.

On the purchase and sale of listed corporate common stock by an individual through a stockbroker, the normal vehicle for such transactions, the stock is purchased or sold at an agreed figure and in addition at the same time the stockbroker normally charges the individual purchaser or seller a commission for his services in purchasing or selling the shares. Where a stockbroker is acting as an underwriter of a stock issue, the stock is offered by the broker-underwriter to the public at a fixed price including the underwriting cost. The issuing corporation receives the amount paid by the purchaser less the underwriting costs.

The applicable lump sum public offering prices, "asked" prices, on January 27, 1964 for shares in each of the subject open-end investment companies include the maximum "sales load" with respect to a share in each company. A quantity purchase discount would have been available to a purchaser on January 27, 1964, had he purchased on that date in a single transaction with each respective mutual

fund the number of shares which the decedent owned on January 27, 1964, in Massachusetts Investors Trust and the Geo. Putnam Fund of Boston. No quantity purchase discount would have been available on January 27, 1964, with respect to a purchase in one transaction of the number of shares which the decedent owned on January 27, 1964, in the Wellington Fund, Inc. Taking into consideration the applicable quantity purchase discounts that would have been available in acquiring the number of open-end investment company shares owned by Frances Foster Wells on the date of her death, January 27, 1964, the "asked" prices as adjusted for the quantity discounts would be as follows:

Massachusetts Investors Trust	$16.99
The Geo. Putnam Fund of Boston	16.30
Wellington Fund, Inc.	16.08

Therefore, under section 20.2031-8 (b), Estate Tax Regs., the fair market value of the shares of open-end investment company stock owned by Frances Foster Wells on the date of her death, January 27, 1964, is no greater than the amounts shown below:

	No. of Shares	Per Share Value	Total Valuation
Massachusetts Investors Trust	1,073	$16.99	$18,230.27
The Geo. Putnam Fund of Boston	3,876.638	16.30	63,189.20
Wellington Fund, Inc.	1,031.601	16.08	16,588.14

These are the valuations finally agreed to by the Commissioner in accord with the regulations.

Simply, the question is whether the Commissioner properly valued, for estate tax purposes, the shares of the open-

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end investment companies owned by the estate. In accordance with Regs. 20.2031-8 (b), *supra*, the value was determined to be the public offering price per share (now by agreement adjusted to the "price available to the public in acquiring the number of shares being valued," as provided in the regulations), in the event we decide for the Commissioner.

Both parties have submitted enlightening briefs. We are persuaded that the Commissioner's determination should be sustained and we follow his reasoning.

Section 2031 (a), I. R. C. 1954,[2] provides that:

> The value of the gross estate of the decedent shall be determined by including to the extent provided for in this part, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated.

Pursuant to the general authority to prescribe regulations found in section 7805 (a), Regs. 20.2031-8 (b), set out in footnote 1, was promulgated in 1963. No contention is made by the petitioner that this section of the regulations was not followed. The validity of the regulation itself is attacked.

It has often been held that Treasury Regulations are to be sustained unless they are found to be unreasonable and plainly inconsist with the revenue statutes. *Commissioner* v. *South Texas Lumber Co.* [48-1 USTC ¶ 5922], 333 U. S. 496 (1948). We think the regulation is reasonable.[3]

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[2] All Code references will be to the Internal Revenue Code of 1954 unless otherwise noted.

[3] *Sometimes* we are persuaded to hold a regulation to be unreasonable and so invalid. *Estate of Lawrence R. McCoy* [Dec. 29,036], 50 T. C. — (July 3, 1968).

In formulating the regulations relating to valuation, open-end investment company shares were included by the Treasury in section 20.2031-8 along with "certain life insurance and annuity contracts," rather than in section 20.2031-2,[4] "Valuation of stocks and bonds," which set the value of the latter at the "mean between the highest and lowest quoted selling prices." Petitioner argues that this is a significant inconsistency which makes the regulation with which we are concerned of doubtful validity.

We think this organization of the regulations was no more than recognition that investment company shares are a different breed of cats from ordinary stocks and bonds; and when it comes to valuing them, a different criterion can reasonably be applied, more nearly like that applied to life insurance and annuity contracts than stocks and bonds.

Of course it can be argued, and with reason, that distinctions between these categories of investments are tenuous; but even petitioner recognizes "there are technical distinctions between mutual funds and other equity securities such as common stocks." He argues such "distinctions are negligible for purposes of valuation." The Treasury evidently thought otherwise. Petitioner points out with reference to stocks and bonds, that the mean between the highest and lowest quotation is used "because the quotations represent the range of prices, as opposed to indicating fixed prices as is the case with mutual funds." To us, this reasonably could be a factor justifying different valuation criteria.

---

[4] Sec. 20.2031-2 Valuation of stocks and bonds.

(a) *In general.* The value of stocks and bonds is the fair market value per share or bond on the applicable valuation date.

(b) *Based on selling prices.* If there is a market for stocks or bonds, on a stock exchange, in an over-the-counter market, or otherwise, the mean between the highest and lowest quoted selling prices on the valuation date is the fair market value per share or bond. • • •

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As argued by the Commissioner:

> * * * the only transactions with the public involving the purchase of open-end investment company shares and thus true market place willing buyer-willing seller transactions are the transactions whereby members of the public purchase the shares at the public offering prices. Therefore, Regs. 20.2031-8 (b), consistent with the valuation concept in Regs. 20.2031-2 (b), provides that the fixed prices at which these transactions occur is taken as the measure of fair market value. Obviously, the transactions whereby the open-end investment companies redeem their shares from the holders are distinguishable from the sales by members of the public to other members of the public in the case of common stocks. Thus a considerable difference exists with respect to the disposition of an open-end investment company share by a member of the public, as this is not a true willing buyer-willing seller transaction.

It is simply a set redemption price. This difference is appropriately recognized in Regs. 20.2031-8 (b).

In addition, the use of the "asked" price is supportable by the cases of *Guggenheim* v. *Rasquin* [41-1 USTC ¶ 10,013], 312 U. S. 254 (1941), and *Estate of Frank Miller Gould* [Dec. 17,539], 14 T. C. 414 (1950). In *Guggenheim*, the issue concerned the method for valuing a life insurance policy—should the value be the amount for which the policy could be surrendered, or what it would cost to purchase it. The Court said:

> Surrender of a policy represents only one of the rights of the insured or beneficiary. Plainly that right is one of the substantial legal incidents of ownership. * * * But the owner of a fully paid life insurance policy has more than the mere right to surrender it; he has the right to retain it for its investment virtues and to receive the face amount of the policy upon the in-

> sured's death. * * * All of the economic benefits of a policy must be taken into consideration in determining its value for gift-tax purposes. To single out one and to disregard the others is in effect to substitute a different property interest for the one which was the subject of the gift. * * * [312 U. S. at 257.]

Likewise, in *Gould*, this Court held that the value of a ring included the tax paid on its purchase.

Both *Guggenheim* and *Gould* involved the determination of value for gift tax purposes. Both cases held that the gift was to be valued by reference to the replacement cost. The donee acquired the ownership of the property including all the uses and privileges of an owner, and accordingly, the gift should be valued at what it would have cost the donee to purchase all those benefits.

If the proper test for valuing a gift is the replacement cost, the same measure of value may appropriately be applied to an estate since it involves testamentary gifts. The estate and the beneficiaries may continue to own the mutual fund shares, and if they do, they would enjoy all the benefits of ownership of the stock, including not only the right to redeem, but also the right to continue to hold the stock and to receive its dividends. In such case, it would be appropriate to tax them on the replacement cost. Moreover, if they do dispose of the shares, no hardship is imposed upon them. Under section 20.2053-3 (d) (2), Estate Tax Regs., if the shares are sold at a loss, such loss is a deductible expense of administration. If the shares are acquired by a beneficiary and subsequently sold by him at a loss, his loss will generally be deductible for income tax purposes. In view of the possibility of continued ownership of the mutual fund shares by the estate and the beneficiaries, and in view of the mitigating adjustments that occur if the shares are later sold at a loss, there appears to be substantial justification for the regula-

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tions using the asked price of replacement cost in valuing the mutual fund shares.

As pointed out in the Commissioner's brief, there are a number of cases holding "estate and gift tax valuation in excess of liquidation value where the asset being valued is not subject to liquidation against the holder's will is proper." *United States* v. *Ryerson* [41-1 USTC ¶ 10,014], 312 U. S. 260 (1941); *Guggenheim* v. *Rasquin* [41-1 USTC ¶ 10,013], 312 U. S. 254 (1941); *DuPont's Estate* v. *Commissioner* [56-1 USTC ¶ 11,607], 233 F. 2d 210 (C. A. 3, 1956), certiorari denied 352 U. S. 878 (1956).

We think this is one of those situations in which the principle set out by the Third Circuit Court of Appeals in *Mearkle's Estate* v. *Commissioner* [42-2 USTC ¶ 10,193], 129 F. 2d 386, is singularly applicable:

> It may well be that there are several methods of valuation which could be resorted to here, and that more than one of those methods would be reasonable. One is set out in the Regulations. * * * Quite obviously a Regulation prescribing a method for valuation is not to be stricken down by the taxpayer's preference for a different method.

Neither party has argued for any other valuation for the shares in question except either the public offering price as set in the regulations or their public redemption price as contended for by petitioner.

The case is decided for the Commissioner in accordance with the regulations.

Reviewed by the Court.

Decision will be entered under Rule 50.

[Dissenting Opinion]

TANNENWALD, Judge, dissenting: It may well be that shares in an open-end investment company are "a different breed of cats from ordinary stocks and bonds" but it does not follow that they are the same breed of cats as life insurance and annuity contracts. It is this assumption as to identity of "breed" which, to my mind, invalidates the decision of the majority herein.

I do not dispute the principle that respondent's regulations should be sustained unless they are unreasonable. But it does not follow that, because respondent has a choice of alternatives, his choice should be sustained where the alternative chosen is unrealistic. In such a situation the regulations embodying that choice should be held to be unreasonable. In my opinion, the regulations involved herein are clearly unrealistic as applied to the factual situation involved herein and therefore to that extent unreasonable.

The touchstone of fair market value has always been the price which a willing seller could reasonably be expected to be able to obtain from a disposition of the property in question. Thus, if shares of stock are subject to a binding restriction, which is the product of an arm's-length transaction, that the shares may not be sold without offering them to a third person at a certain price, that price becomes the ceiling for determining the fair market value of the shares for estate tax purposes. Section 20.2031-2 (h), Estate Tax Regs.; *Rev. Rul.* 59-60, 1959-1 *C. B.* 237; see Casner, Estate Planning (1961 ed.), pp. 945-951. Similarly, when the open market price of bonds is less than par but the bonds can be applied at par in payment of the decedent's estate tax, the par value is includable in the gross estate. *Bankers Trust Co.* v. *United States* [61-1 USTC ¶ 11,985], 284 F. 2d 537 (C. A. 2, 1960),

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certiorari denied 366 U. S. 903 (1961); *Candler* v. *United States* [62-2 USTC ¶ 12,080], 303 F. 2d 439 (C. A. 5, 1962).

The rationale of *Bankers Trust* was that because the bonds could be redeemed at par in payment of estate taxes, they were worth more (*i.e.*, the estate could reasonably be expected to obtain more) than the discounted price in the open market. It considered this an important element of value and applied respondent's own regulation that

> All relevant facts and elements of value as of the applicable valuation date should be considered *in every case*. [See 284 F. 2d at p. 538; sec. 20.2031-1 (b), Estate Tax Regs.]

I think the same rationale should apply here. The majority has found that, "Except for a negligible number of transfers between individuals, all transactions with respect to open-end investment companies or mutual fund shares take place with the particular open-end investment company or mutual fund whose shares are involved." "Negligible" means "of so little substance or extent or worth as to be practically nonexistent." Webster's International Dictionary (1965). In light of the majority finding, we need not speculate on what our decision would be in a case where there was proof of some market in which the shares of an open-end investment company could be sold in addition to the availability of redemption by the company.

In the life insurance cases, the courts were obviously influenced by the facts that the insurance is a different "breed" due to the element of insurability, or lack thereof, of the insured at the time of the transfer and the significant increment which would be received on the death of the insured; that, shortly before the policy was transferred, the taxpayer had paid a substantially higher price for the

insurance than its cash surrender value; and that there was no evidence that the policy could not have been sold, albeit in a limited market, at its replacement value or at least at a price in excess of its cash surrender value. *United States* v. *Ryerson* [41-1 USTC ¶ 10,014], 312 U. S. 260 (1941), decided on the same day as *Guggenheim* v. *Rasquin* [41-1 USTC ¶ 10,013], 312 U. S. 254 (1941); *DuPont's Estate* v. *Commissioner* [56-1 USTC ¶ 11,607], 233 F. 2d 210 (C. A. 3, 1956). In this connection, it is not without significance that the Internal Revenue Code itself recognizes that life insurance policies are transferable for a valuable consideration. Section 101 (a), I. R. C. 1954.

The cases involving excise taxes (*Publicker* v. *Commissioner* [53-2 USTC ¶ 10,912], 206 F. 2d 250 (C. A. 3, 1953); *Duke* v. *Commissioner* [52-2 USTC ¶ 10,877], 200 F. 2d 82 (C. A. 2, 1952); and *Estate of Frank Miller Gould* [Dec. 17,539], 14 T. C. 414 (1950)) simply decided that, in the absence of any other probative evidence of fair market value, the price that the taxpayer paid was determinative of that value. They are therefore clearly distinguishable.

The language from *Mearkle's Estate* v. *Commissioner* [42-2 USTC ¶ 10,193], 129 F. 2d 386, 386-388 (C. A. 3, 1942), quoted in the majority opinion, must be considered in the context of the factual situation involved in that case. The question before the Court of Appeals was whether replacement cost was a proper measure for valuing annuity policies for estate tax purposes. Citing the life insurance cases, the Court of Appeals emphasized that it had not been shown that the differences in life insurance and annuity contracts were of such significance as to justify a different method of valuation—*i.e.*, they were "the same breed of cats." Herein lies the critical difference—in this case we have proof of a different breed.

The reference to section 20.2053-3 (d) (2), Estate Tax Regs., furnishes scant, if any, support for the majority view.

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In the first place, the fact that respondent may have thus sought to cushion the effect of section 20.2031-8 (b) does not justify a departure from the usual fair market value standard. In the second place, an equivalent countervailing loss will be available only if spread between the redemption price and the "offering price" is no less on the date of actual redemption than it was on the valuation date for estate tax purposes—a situation which is by no means guaranteed. In the third place, the loss is available only to the estate and then only under the limited conditions prescribed by the first sentence of section 20.2053-3 (d) (2);[1] it is of no benefit to a beneficiary of the estate to whom the shares are distributed.

The emphasis by the majority on the fact that the estate and the beneficiaries may continue to own the mutual fund shares and thereby enjoy the benefits of ownership is, in my opinion, wholly misplaced. These possibilities exist with respect to every type of security. If the majority standard is correct, it would be no less "appropriate" to use replacement cost with respect to marketable securities of all kinds. This, however, is simply not the law. That there may be an equivalence of replacement cost and fair market value in some situations does not justify the substitution of the former for the latter as the criterion in other situations where different considerations are involved.

The plain fact is that, on the record in this case, petitioner could not dispose of the open-end investment company shares except by way of a sale to the open-end investment companies at the redemption price. That price was all that petitioner could obtain. It is the total amount obtainable by the seller from the only available actual

[1] The first sentence of sec. 20.2053-3(d)(2), Estate Tax Regs., reads: "Expenses for selling property of the estate are deductible if the sale is necessary to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate, or to effect distribution."

purchaser, not the price which a theoretical purchaser would pay another seller, which should control. See Report of the Committee on Estate and Gift Taxes, Vol. XIX, Bulletin of the Section of Taxation of the American Bar Association No. 4 (July 1966), pp. 73-76.

I would hold for petitioner.

DRENNEN, ATKINS, FORRESTER, FAY, and IRWIN, Judges, agree with this dissent.

In the Supreme Court of the United States

OCTOBER TERM, 1969

No. 1459

EUGENE P. RUEHLMANN, EXECUTOR OF THE ESTATE OF FRANCES FOSTER WELLS, DECEASED, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

Frances Foster Wells died on January 27, 1964, owning shares in three open-end investment companies (Pet. App. 18). The sole question presented in this proceeding is the proper valuation of those shares for federal estate tax purposes.

Open-end investment companies (mutual funds) are organizations which issue as many of their shares as can be marketed and invest the proceeds in securities of other firms. The price at which shares in such companies are offered to the public ("asked" price) is net asset value (fractional value per share of the fund's net assets) plus a "sales load," the latter representing the payment given to underwriters and agents for

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their services in marketing the shares. The "sales load" may constitute as much as 8.5 percent of the net asset value of the shares. When the owner of such shares desires to sell them, the open-end investment company which issued them is, except in rare circumstances, the only available buyer. The shares are required by law to be redeemed by the issuer at net asset value ("bid" price). (Pet. App. 18–21.)

In the federal estate tax return filed on behalf of the Estate of Frances Foster Wells, petitioner valued the open-end investment company shares at their respective "bid" prices (Pet. App. 20–21). The Commissioner of Internal Revenue, following the method prescribed by Section 20.2031–8(b) of the Treasury Regulations on Estate Tax (1954 Code), valued the shares at the higher "asked" prices (Pet. App. 17). Petitioner challenged the resulting proposed deficiency in estate tax ($2,328.25) in the Tax Court on the ground that Section 20.2031–8(b) is arbitrary, unreasonable and inconsistent with Section 2031 of the Internal Revenue Code of 1954. The latter provision requires inclusion in the gross estate of the "value" of all property owned by a decedent at the time of death (Pet. App. 18, 23). In a reviewed decision, the Tax Court (six judges dissenting) sustained the action of the Commissioner (Pet. App. 27) and, upon petitioner's appeal, the Sixth Circuit affirmed (Pet. App. 17).

There is no conflict of appellate court decisions or any other basis for further review by this Court at this time.

1. Section 2031 of the 1954 Code requires inclusion in the gross estate of the "value" of all property owned by the decedent. Section 20.2031–1(b) of the Treasury Regulations, implementing that provision, states that value is "fair market value"—"the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." The basic difficulty here is that this classical definition of fair market value cannot easily be applied to open-end investment company shares, for which two markets exist—one in which they are bought, and one in which they are sold. Under these circumstances, the fair market value of such shares is either their redemption value ("bid" price) or replacement value ("asked" price), and a comparison of the majority and the dissenting opinions in the Tax Court discloses that there are many arguments supporting the selection of one and many supporting the selection of the other.

In this situation, the Commissioner, dealing with the specific situation, has prescribed the use of the "offering price," *i.e.*, the asked price. Sec. 20.2031–8(b) of the Treasury Regulations on Estate Tax. The case is thus one calling for the approach followed by this Court in *United States* v. *Correll,* 389 U.S. 299. There the Court held (*id.,* pp. 306–307) that the administrative construction of a tax statute is not to be set aside merely because alternatives to the Commissioner's rule are available or improvements may be imagined.

2. In any event, the issue presented is not ripe for review by this Court. The Sixth Circuit's conclusion is in accord with *Howell* v. *United States,* 414 F. 2d 45 (C.A. 7), affirming 290 F. Supp. 690 (N.D. Ind.), in which the gift tax counterpart of Section 20.2031-8 of the Estate Tax Regulations was approved, and also with *Norton* v. *United States,* W.D. Wash., Civ. No. 3666, decided November 26, 1969, and *York* v. *Commissioner,* T.C. Memo. 1969-246, ¶ 69, 245 P.H. Memo. T.C. Petitioner relies on the decision in *Davis* v. *United States,* 306 F. Supp. 949 (C.D. Calif.), now pending on appeal in the Ninth Circuit (Pet. 8–9). There is no basis for review here, however, unless and until the Ninth Circuit affirms *Davis,* thereby creating a conflict of appellate court decisions.[1]

3. Although petitioner argues that the question of valuation of open-end investment company shares may affect "potentially millions of taxpayers" (Pet. 6), there is no suggestion in the petition that the decision below will have a significant impact on the revenues. Section 1014 of the 1954 Code provides that property acquired from a decedent shall take as its basis for income tax purposes the fair market value of the property as determined for estate tax purposes.

[1] Petitioner also contends (Pet. 9–11) that the decision below is inconsistent with *Guggenheim* v. *Rasquin,* 312 U.S. 254; *Powers* v. *Commissioner,* 312 U.S. 259; and *United States* v. *Ryerson,* 312 U.S. 260, in which this Court held that, for gift tax purposes, single-premium life insurance policies are to be valued at their replacement cost, rather than cash surrender value. There is no inconsistency as asserted, since the court below also applied the replacement cost rule for the purpose of valuing mutual fund shares.

Accordingly, the higher estate tax yield from the Commissioner's method of valuing mutual fund shares may be more than offset by the resulting higher tax bases of such shares for income tax purposes. A relatively small fraction of estates actually pay any federal estate tax, but the higher income tax basis is allowed whether or not an estate tax has been paid. The fiscal impact of the method used for valuing shares of this type thus cannot be of substantial importance either to the Commissioner or to taxpayers as a class. If, however, a conflict of appellate court decisions develops, the issue here will be of widespread administrative importance, affecting not only estate and gift tax liabilities, but, in view of the basis rules, income tax liabilities as well.

The petition for a writ of certiorari should be denied. Alternatively, as petitioner proposes (Pet. 12), action on the petition should be deferred pending disposition of the *Davis* case by the Ninth Circuit.

Respectfully submitted.

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In the

Supreme Court of the United States

OCTOBER TERM, 1969

No. 1459

EUGENE P. RUEHLMANN, EXECUTOR OF THE ESTATE OF FRANCES FOSTER WELLS, DECEASED,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF AMICUS CURIAE ON BEHALF OF GEORGE R. BRADLEY, EXECUTOR UNDER WILL OF M. WINIFRED ANDERSON, IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

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Interest of Amicus Curiae

This brief *amicus curiae* is filed with the written consent of the Solicitor General and of the petitioner's counsel. It is filed on behalf of the taxpayer in a case at issue, but not yet tried, pending in the United States District Court, Western District of New York (Civil No. 11,873), seeking refund of estate taxes on the identical legal and constitutional grounds which form the basis for the petition herein. The decedent in the New York case died on February 10, 1964, only two weeks after the death of the Ohio decedent in the case at bar.

ARGUMENT

A Writ Should be Granted to Resolve this Widely-debated Issue of Constitutional and Public Importance.

The wide importance of the issue, described in the petition, to thousands of executors and legatees appears self-evident. Nearly every estate of any size today contains some "mutuals". Indeed, in the aforesaid New York case, virtually the entire estate consists of such securities. We earnestly submit that a writ should be granted because of the importance of the issue, irrespective of any present conflict in lower courts.

The estate tax is not an inheritance tax or a property tax, but is a transfer tax. It is imposed upon the *transfer* of property of a decedent, not upon its *receipt* by a legatee; upon its market value, not upon its replacement value.

Section 2031 (a) of the Internal Revenue Code provides that the value of a decedent's intangible personal property shall be determined by its *value* at the time of death. The term "value" has been defined in Section 20.2031-1 (b) of the Estate Tax Regulations as the "fair market value" of the property, which is again defined generally as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts". The fundamental purpose of the Code, reflected in the quoted section of the Regulations, is to value intangible personal property of a decedent at the price which it would bring if sold and liquidated in a fair market on the date of death.

The position of the petitioner is in accord with the definition of an open-end investment company set forth in the Investment Company Act of 1940. Section 5 (a) of that

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Act defines such a company as one "which is offering for sale or has outstanding any redeemable security of which it is the issuer." The term "redeemable security" is defined in Section 2 (a)(31) of that Act to mean "any security, other than short-term paper, under the terms of which the holder, upon its presentation to the issuer or to a person designated by the issuer, is entitled (whether absolutely or only out of surplus) to receive approximately his proportionate share of the issuer's current net assets, or the cash equivalent thereof." Thus the shares in such a company are, by statutory definition, securities for which the holder upon demand is entitled to receive "approximately his proportionate share of the issuer's current net assets, or the cash equivalent thereof."

Virtually all open-end investment companies offer their shares for public sale through underwriters. In the typical situation the national underwriter resells the shares to local dealers, who in turn sell them to investors. The price at which the company sells to the underwriter is the current net asset value of the shares; the underwriter thereupon sells to the dealer at net asset value plus a small sales charge; and the dealer resells to the investor at the latter amount plus a further charge, generally from 5% to 7%, necessary to meet the expenses of operation, commissions of salesmen, and a profit, if any.

The offering of shares for sale through public distribution at a price above net asset value is not an indication that the shares have a value greater than net asset value. The addition of a sales charge is merely a reflection of the cost and expense to the underwriter and dealers of maintaining the public distribution system — the expense of offices, clerical staffs, salesmen, telephone and telegraph, printing, advertising, etc. — together with a potential

profit for those who spend their time and risk their capital in the endeavor. The investment company itself does not incur this expense or earn the sales charge; it derives neither profit nor loss from the public distribution activity, which is solely for the account of the underwriter and the dealers.

In every case the amount which is paid in to the investment company itself, and which is available in its hands for investment in a portfolio of securities, is limited to an amount equal to the net asset value alone. And this is the amount available to the investor upon presentation of his shares for redemption.

Quotations as to the prices of open-end investment company shares are set forth daily in the financial sections of the newspapers. Most companies calculate net asset value twice daily, once at midday and again at the close of the New York Stock Exchange. The prices quoted in the newspapers represent the closing prices for the day. Two prices are set forth for each company, one called for convenience the "bid" and the other the "asked". These terms originated in respect of *other* types of securities on the stock exchanges and on the over-the-counter markets where prices are subject to negotiation and bargaining. However, these terms, when applied to "mutuals", are merely used for convenience and do not reflect any negotiation or bargaining. As used by newspapers and in popular parlance, the term "asked" means the maximum public offering price in accordance with the company's prospectus, (*i.e.*, net asset value per share plus the maximum sales charge per share); and the term "bid" means the net asset value, at which the company stands ready to redeem its shares.

The essential features of open-end investment companies are (a) that their assets consist of marketable securities with publicly known values, and (b) that their shareholders

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have an interest in the company which entitles them upon demand to a proportionate part of its net assets or the cash equivalent thereof.

The value of each asset owned by the company is a known factor, because each asset is separately valued daily by accepted standards. The potentiality of the company for realizing income, as well as its potentiality for capital appreciation, is fully reflected in the sum total of the value of its assets, for each of its assets reflects those potentialities as they are judged in the market place by the current price at which they sell. There are no added values in a portfolio of securities which enlarge their value beyond the sum of the values of the individual securities.

Certainly in the valuation of the estate of a decedent who dies owning a variety of different securities, it has never been thought that his estate has an added value above and beyond the sum total of the values separately determined for each individual security. Similarly, there is no reason to attribute to a decedent's estate, which owns an interest in a joint securities account, a value beyond its pro rata share of the sum total of the values of the individual securities held in the account. The valuation rule should be no different for an interest in an investment company in which each shareholder has the right upon demand to withdraw his proportion of the net assets or their current value. Otherwise the sum total of the shareholders' pro rata interests in such a fluctuating fund would exceed the value of the fund as a whole; and federal taxes would be collected from the shareholder group as a whole on a basis which is mathematically incorrect.

The basic concept of open-end investment companies, with their capital structures constantly fluid as shareholders enter and leave the fold daily, is that shares are to be issued and redeemed by the company at net asset

value. This is essential for the protection of existing shareholders in order to prevent dilution of the value of their interests. Redemptions are not permitted at a price above net asset value because to do so would dilute the value of the interests of the remaining shareholders. Thus the practice in respect of redemptions is not merely evidence of the value of the pro rata interest of the withdrawing shareholder, but it reflects the value of the pro rata interests of the remaining shareholders as well. It demonstrates that the value of the right to remain in the company as a shareholder is the same as the value of the right to withdraw; the value of either or both rights is the net asset value. The fundamental method of open-end operation is premised upon the theory, therefore, that the value of each outstanding share is its net asset value.

The above principle is entirely consistent with time-honored valuation methods for federal tax and other purposes. Indeed, the opposite notion embodied in the challenged Regulation is contrary to such history. As previously stated, the sales charge, comprising part of the "public offering price" — separately itemized as required by the Securities and Exchange Commission — is merely a cost of acquisition by the investor. It adds nothing to the value of the shares, which is always the net asset value per share. It is comparable to purchase-commissions paid to acquire securities listed on the New York Stock Exchange. Such costs of acquisition are not taken into account in determining values for federal tax purposes. For example, the Estate Tax Regulations provide, as they have for many years, that for stocks traded on a stock exchange, "the mean between the highest and lowest quoted selling prices on the valuation date is the fair market value per share." (Section 20.2031-2[b]) The commission necessarily paid to a broker to make the purchase, and the stock exchange fee

and the stock transfer fee, are all a part of the acquisition cost — and would be included in "replacement cost" if that were the proper standard — but under this long-established rule they are not included in determining value for federal estate-tax purposes. This is obviously a correct principle, for such acquisition costs add nothing to the basic value of the stock. Similarly, the costs of selling the stock are not taken into account, since — although they affect the net realizable amount — they do not detract from the basic value of the stock.

To employ a different standard for valuing the shares of open-end investment companies is to employ different valuation techniques to interests in securities according to the form of transactions although their substance is identical; and this is arbitrary because inconsistent, illogical, and discriminatory.

The fact that the excess of the offering price over net asset value represents only an acquisition cost to the shareholder, adding nothing to the marketability of a share, and forming no part of its value, is clearly brought out in the typical prospectus furnished to each investor. For example, the outside front cover page of the Massachusetts Investors Trust prospectus (current on the deaths of decedents both in the New York case and in the case at bar) states:

> "The price to the public for shares offered by this prospectus varies with the fluctuations in the market value of securities owned by the trust. It is determined twice daily and is *net asset value plus a sales charge* equal to 8.5% (maximum) of the offering price, scaled down to 2-½% (minimum) depending upon size of purchase as more fully described on page 6." [Italics supplied.]

Similarly the prospectus of The Geo. Putnam Fund of Boston states on its cover page as follows:

> "The price to the public of the shares offered by this Prospectus varies with the fluctuations in the market

value of the securities owned by the Fund. The offering price is determined twice daily and is normally the net asset value per share plus a sales charge of 8-½% of the offering price, with reductions for sales in excess of $10,000, as more fully described under the caption 'Selling Price of Shares' at page 3 herein."

Thus the investor is fully informed that the offering price is not deemed a measure of the value of the shares, but is a figure compounded of (a) the true value, and (b) an additional amount spelled out as a sales commission, distribution charge, or sales charge. By the rules of the Securities and Exchange Commission it must be so spelled out in every prospectus.

Still another indication of the nature of the public offering price, in relation to the true net asset value, lies in consideration of those companies for whose shares no sales charge is imposed. The shares of a number of investment companies (*e.g.*, Scudder, Stevens & Clark Fund; Loomis-Sayles Fund; Stein, Roe & Farnham Fund) may be purchased at a public offering price precisely equal to net asset value. This is so because the underwriters for these companies maintain no dealer organization or staff of sales representatives; investors are not personally solicited but must take the initiative and apply directly to the underwriter. There is thus comparatively little, or no, sales expense or effort involved for which a sales charge would be appropriate. Yet the value of a shareholder's interest in such a company is no less than, or more than, the value of an interest in a company for whose shares a sales charge is imposed, assuming, of course, that the portfolios of the two companies were identical. It is wrong in principle and arbitrary in practice to value the shares in the two companies on different bases simply because a sales charge or commission must be paid to a third party in acquiring shares in one and not the other company. Such a rule

clearly conflicts with the sound and long-established principle that neither acquisition costs nor sales expenses are to be considered in the valuation of securities.

Moreover, the sum realizable by any legatee under a decedent's will would not be the "public offering price", but only the redemption value of the shares transferred by death. Hence to value a security, as here, at a figure which no executor, distributee, or legatee could realize on its liquidation is unrealistic and arbitrary, and results in a confiscatory tax. The validity of the position of the petitioner is strikingly portrayed in a situation where some purchaser of a "mutual" decided immediately thereafter to dispose of it. He could get back only the redemption price, although he had just paid the "public offering price." In other words, at all times the true and fair "value" of the security, as intended by the Internal Revenue Code, is the net asset or redemption value.

Finally, we refer again to Section 20.2031-1 (b) of the Estate Tax Regulations defining "fair market value" as generally meaning "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." This definition obviously is intended to apply to the ordinary market place where bargaining and negotiation ultimately result in an agreement which fixes the "value." But the market for mutual fund shares is a unique type of market. The latter is not a market place where buyer and seller meet and battle it out. If the owner of mutual shares wishes to sell them, the *only* buyer which the *willing seller* may find is the investment company itself. Being the *only* buyer, the investment company becomes a *willing* buyer only and invariably at the *net asset value.* Therefore, to consider anything over and above that value for estate-tax purposes is

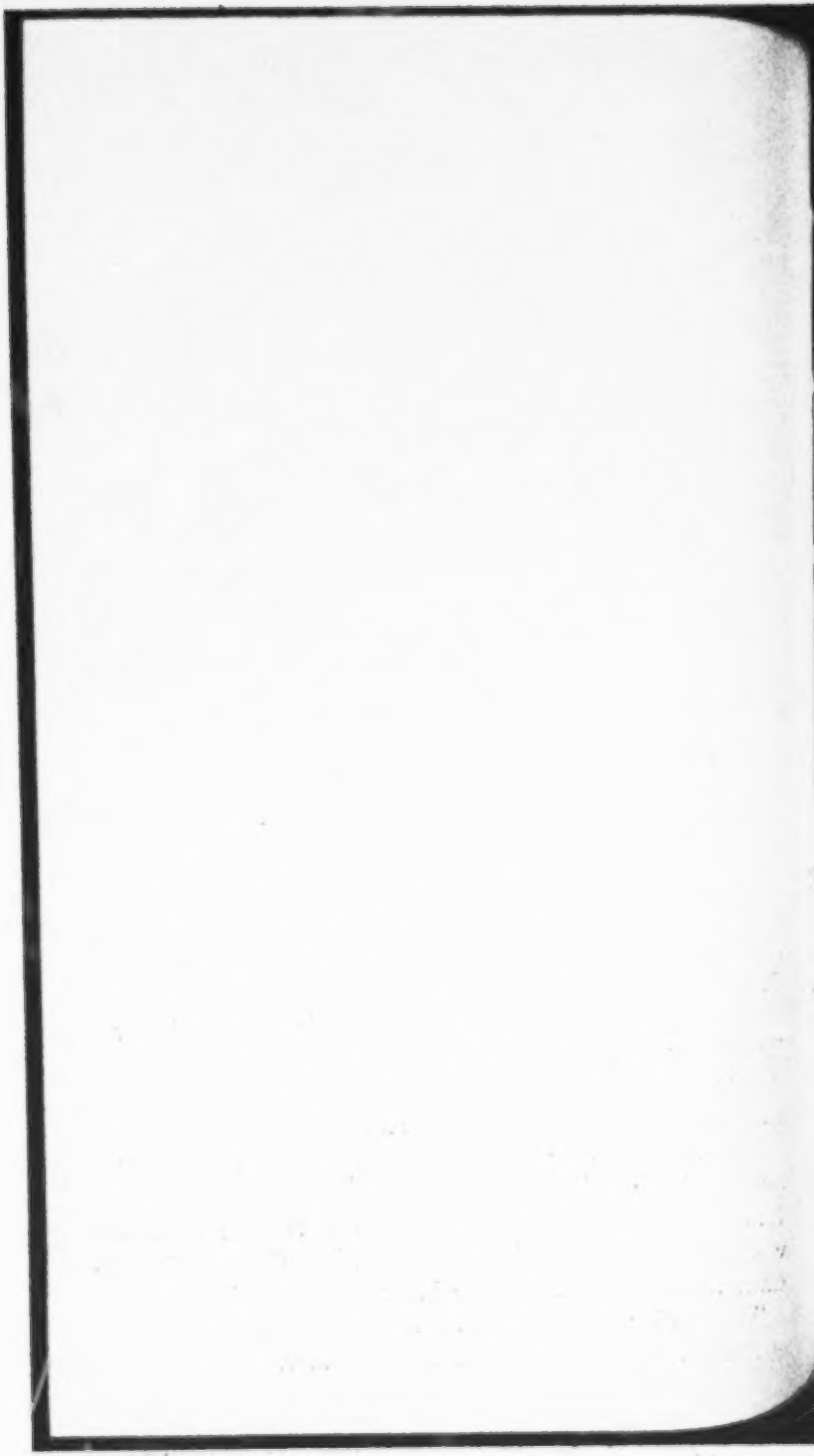
not only unrealistic but arbitrary, and to exact an estate tax on any other basis than such value deprives the taxpayer of his property without due process of law in violation of the Fifth Amendment to the Constitution of the United States.

CONCLUSION

A Writ of Certiorari should be granted.

Respectfully submitted,

HENRY S. FRASER
Counsel for Amicus Curiae



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In the

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1969

No. 1459

EUGENE P. RUEHLMANN, EXECUTOR OF THE ESTATE OF FRANCES FOSTER WELLS, DECEASED,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR REHEARING ON A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

On June 8, 1970, this Court entered an Order denying the Petition for Writ of Certiorari in the above-entitled Case.

Pursuant to Rule 58, we enter this Application for Rehearing of Order on the Petition for Writ of Certiorari in *Wells* v. *Commissioner of Internal Revenue,* 418 F.2d 1302 (6th Cir. 1969), Docket No. 1459.

We ask this Court to postpone its decision on this Petition until the Ninth Circuit Court of Appeals decides *Robert C. Davis, Executor of Estate of Isabelle M. Davis* v. *United States,* 306 F. Supp. 949 (C.D. Calif. 1969) because *Davis* involves an issue identical to that in Wells.

The Justice Department, in its brief for the Respondent, at Page 5, also suggest this as an alternative.

If the Ninth Circuit Court of Appeals in *Davis* disagrees with the Sixth Circuit's decision in Wells, the result would be a conflict between circuits. Such a conflict would necessitate this Court's review of both cases.

Therefore, we pray that the Court defer its decision on this Petition for rehearing, allowing us to preserve our position, until such time as *Davis* has been decided.

CERTIFICATE OF COUNSEL SUPPORTING PETITION

I hereby promise that such petition for rehearing of the order on the Petition for Rehearing on Writ of Certiorari is presented in good faith and not for delay and that the Petition is restricted to the grounds above specified.

.....

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